

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Coto Analyst: Victoria Favorito Bill Number: AB 393
Related Bills: None Telephone: 845-3825 Introduced Date: February 15, 2007
Attorney: Tommy Leung Sponsor: _____

SUBJECT: Mortgage Insurance Premiums Deduction Conformity

SUMMARY

This bill would conform to the current federal law allowing homeowners to claim the amount paid for mortgage insurance premiums as a current deduction.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to make home ownership more affordable in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment, and would apply to taxable years beginning on or after January 1, 2007.

POSITION

Pending.

ANALYSIS**FEDERAL/STATE LAW****Current Federal Law**

The Tax Relief and Health Care Act (TRHCA) of 2006 (P.L. 109-432), amended the Internal Revenue Code (IRC) definition of "qualified residence interest" to include qualified mortgage insurance premiums paid or accrued during the taxable year in connection with the mortgage debt incurred for the purchase of a "qualified residence." This provision only applies to premiums paid or accrued during 2007.

Qualified resident interest means any interest paid for or accrued during the taxable year in connection with mortgage debt incurred for the purchase of a "qualified residence." The amount deducted must not exceed the cost of the home, that is, the qualified principal or second residence, plus the cost of improvements.

Board Position:

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Department Director

Date

Selvi Stanislaus

3/21/07

For purposes of this deduction, qualified mortgage insurance means mortgage insurance provided by the Veterans Administration, the Federal Housing Administration, or the Rural Housing Administration, and private mortgage insurance (defined in section 2 of the Homeowners Protection Act of 1998 as in effect on the date of enactment of the provision).

A “qualified residence” is the taxpayer’s main home or second home. A home includes a house, condominium, cooperative, mobile home, house trailer, boat, or similar property that has sleeping, cooking, and toilet facilities.

The amount of the deduction begins to phase out if Adjusted Gross Income (AGI) exceeds \$100,000 for single and joint filers (\$50,000 for married filing separate filers (MFS)). The deduction is phased out at a rate of 10% for each \$1,000 (\$500 if MFS) by which AGI exceeds the limitation. Thus, the deduction is not allowed if the taxpayer’s AGI exceeds \$110,000 (\$55,000 in the case of a married individual filing a separate return).

Individuals who claim the deduction for mortgage insurance premiums are not permitted to prepay premiums that are otherwise due after 2007.

The provision expires for any premium payment paid or accrued after December 31, 2007. If a mortgage (other than a VA, FHA, or RHS mortgage) is prepaid during 2007, the unamortized premium balance on that mortgage is not deductible.

Current State Law

California conforms to the federal law for deducting qualified residence interest. Qualified residence interest means any interest paid or accrued during the taxable year in connection with mortgage debt incurred for the purchase of a “qualified residence.”

Under federal law, mortgage insurance premiums paid or accrued in connection with acquiring a qualified residence are treated as “qualified residence interest” and therefore deductible. However, California does not conform to this provision treating mortgage insurance premiums as “qualified residence interest.”

The Franchise Tax Board receives copies of the federal information returns that businesses file when reporting mortgage interest received in trade or business from individuals.

THIS BILL

This bill would conform the Personal Income Tax Law (PITL) to the new federal law allowing homeowners to deduct the amount of mortgage insurance premiums paid for loans originated in 2007.

IMPLEMENTATION CONSIDERATIONS

Once the technical consideration discussed below is resolved, implementing this bill would not significantly impact the department’s programs and operations.

TECHNICAL CONSIDERATIONS

The TRHCA made federal changes by amending IRC sections 163(h)(3) and 163(h)(4)). For clarity, the author may consider adding the IRC section numbers relating to qualified residence interest and other definition and special rules. Amendment 1 is provided to resolve these issues.

California fiscal taxpayers are unable to receive the full benefit of this deduction because the operative date for this bill would be for taxable years beginning on or after January 1, 2007. To resolve this issue, the author may consider adding an operative date to specify that the deduction shall apply to mortgage contracts issued on or after January 1, 2007, and for amounts paid or accrued after December 31, 2006. Amendment 1 is provided to resolve these issues.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Review of *Florida, Illinois, Massachusetts, Michigan, and New York* laws found no comparable deductions.

Minnesota conforms to the federal change for deducting mortgage insurance premiums.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the personal income tax revenue loss from this bill would be as follows:

Estimated Revenue Impact of AB 393 Operative On Or After January 1, 2007 and Before January 1, 2008 Enactment Assumed After June 30, 2007 (\$ in Millions)			
Mortgage Insurance	2007-08	2008-09	2009-10
	-\$3	\$0	\$0

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

This estimate is based on the Joint Committee on Taxation estimate of the cost to the Federal Government from the similar provision in the TRHCA. The Federal estimate was adjusted for state-national differences in the number of homeowners, and in the tax rates.

The provision applies only to insurance payments made during 2007.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 393
As Introduced February 15, 2007

AMENDMENT 1

SECTION 1. Section 17205 is added to the Revenue and Taxation Code, to read:

17205. (a) Sections ~~163~~ 163(h)(3) and 163(h)(4) of the Internal Revenue Code, as amended by Section 419 of the Tax Relief and Health Care Act of 2006 (Public Law 109-432), relating to ~~premiums~~ qualified residence interest and other definition and special rules, shall apply, except as otherwise provided, to amounts paid or accrued for mortgage insurance on or after January 1, 2007, and before January 1, 2008, shall apply.

(b) This section shall become operative for mortgage insurance premiums paid or accrued on or after January 1, 2007 and before January 1, 2008.